Supreme Court, U.S.
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No. 95-358

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1995

GENE E. RICE, et al.,
Petitioner,

v.

THE RESOLUTION TRUST CORPORATION, et al.,
Respondent

On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit

PETITIONERS' REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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I. INTRODUCTION

This Court already has granted certiorari and heard argument in *Matsushita Elec. Ind. Co. v. Epstein*, 64 U.S.L.W. 3 (1995) to answer the question whether a federal court may withhold full faith and credit from state court final judgment approving class action settlement on the grounds that the settlement released federal claims. This petition, as highlighted by the opposing briefs filed by the Resolution Trust Corporation ("RTC")[1] and Pinnacle West Capital Corporation ("Pinnacle") (collectively "respondents"), poses the related and equally significant question about whether a federal court can bar state law based claims against non-parties, over which the federal court had no jurisdiction, in order to facilitate the settlement of federal securities law based actions.

The RTC and Pinnacle agree that Pinnacle was a party to only six out of the seven actions covered by the settlement. [Pinnacle's Opp. at 19] The significance of Pinnacle's non-party status is that (i) the district court did not have jurisdiction to bar petitioners' state law claims against Pinnacle and (ii) the district court lacked an adequate foundation to determine whether there was a good faith settlement. More specifically, although this Court has recognized the presumption against jurisdiction, respondents have not argued against application of that presumption. Nor have respondents offered any support for the radical extension of federal power effected by approval of the

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[1] The RTC should have terminated on December 31, 1995 in accordance with the provisions of the Resolution Trust Corporation Completion Act, 12 U.S.C. Sections 1441a(m)(1) and (2). At that time, the assets and liabilities of the Resolution Trust Corporation should have been transferred to the Federal Deposit Insurance Corporation ("FDIC") and notice of substitution provided to all parties and the Court. 12 U.S.C. Section 1821a(a)(1). Since no such notice has been provided, and for the sake of consistency, petitioners shall continue to refer to the RTC rather than the FDIC.

settlement's barring indemnity claims against non-parties. Instead, respondents rest after merely trying to distinguish the cases cited by petitioners.

Finally, the RTC and Pinnacle try to blur the distinction between federal securities law applicable to the actions in which Pinnacle was a party and the state law action in which Pinnacle was not a party. In fact, the proportionate judgment rule adopted by the district court is not co-extensive with Arizona's common-law indemnification rules for passive negligence. Under Arizona law, individuals who commit "passively" breaches of duty are entitled to indemnification from actively negligent tortfeasors.

II. THE COURT SHOULD HEAR THIS PETITION BECAUSE IT HAS ALREADY GRANTED CERTIORARI ON A RELATED ISSUE.

The power of a court to bar claims that are not before it merits Supreme Court review. This Court recently heard argument in *Matsushita* about what effect to give to a state court settlement that purported to bar federal securities law claims which the state court did not have jurisdiction to hear. *Matsushita Elec. Ind. Co. v. Epstein*, *supra*. This petition asks the related and equally important question about whether a federal court can bar claims against non-parties to facilitate the settlement of federal securities law actions. For the reasons set forth in the petition, and in this reply, the Court should grant the petition and answer this important question.

III. THE DISTRICT COURT'S ORDER BARRING PETITIONERS' INDEMNITY AND CONTRIBUTION CLAIMS AGAINST A NON-PARTY WAS AN UNWARRANTED EXTENSION OF JUDICIAL POWER; THE NINTH CIRCUIT'S AFFIRMANCE OF THAT ORDER CONFLICTS WITH THE TENTH CIRCUIT.

As an initial matter, respondents do not contest that:

> Federal courts are courts of limited jurisdiction. They possess only power authorized by Constitution and statute, which is not to be expanded by judicial decree. It is to be presumed that a cause lies outside this limited jurisdiction, and the burden of establishing the contrary rests upon the party asserting jurisdiction.

Kokkonen v. Guardian Life Ins. Co. of America, 114 S.Ct. 1673, 1675, 120 L.Ed.2d 391 (1994) (Emphasis added.)

Respondents instead attempt to factually distinguish *Kokkonen* and *FDIC v. Geldermann, Inc.*, 975 F.2d 695 (10th Cir. 1992). However, the point is that there is a presumption against jurisdiction, which respondents never even attempt to rebut. This silence is deafening when Pinnacle, the non-party corporation seeking to hide behind a claims bar in the *RTC* action, opposes the petition without addressing the issue.[2]

With regard to *Geldermann*, Pinnacle's purported distinctions from the present case actually underscore the factual

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[2] Pinnacle in its hurry to distinguish *Kokkonen* fails to correctly set forth the factual background. Pinnacle West erroneously states the settlement was "agreed upon in a case where all the parties to the settlement were before the court." [Pinnacle's Opp. at 19] As set forth previously, Pinnacle West was not a party to the RTC's lawsuit against the non-settling defendants.

similarities. First, in *Geldermann*, the Tenth Circuit rejected a bar order in favor non-parties. Id at 696. Quoting Pinnacle,

> the defendants in lawsuit "A" had potential claims for contribution and indemnification against the persons who were defendants in lawsuit "B." The FDIC entered into a settlement with the defendants in lawsuit "B" and, as additional consideration to those defendants, agreed that a bar order precluding any claims for contribution and indemnification against them by the lawsuit "A" defendants was to be entered in lawsuit "A."

[Pinnacle's Opp. at 20]

Here, petitioners have indemnification and contribution claims against Pinnacle, which is not a party to the state law based *RTC* action. Yet Pinnacle is a party to the other six actions based upon federal securities law. Critically, the degree of interrelatedness between the federal securities law actions and the RTC action cannot reasonably be determined without reference to a claim against Pinnacle in the *RTC* action. *See Epstein v. MCA, Inc.*, 50 F.3d 644, 664-666 (9th Cir.), *cert. granted*, 64 U.S.L.W. 3 (1995) (state settlement cannot bar federal securities law action when state and federal claims arose out of the same transaction but are based upon different facts).

Pinnacle also asserts as a distinguishing fact that unfairness of the *Geldermann* settlement was compounded by the use of the pro tanto rather that proportionate judgment method. [Pinnacle's Opp. at 21] Yet, as discussed *infra* in Section V, the proportionate judgment rule is not co-extensive with indemnification under Arizona law because passively negligent acts or breaches of fiduciary duty are subject to complete indemnification from active tortfeasors.

Respondents respond that Pinnacle contributed to the

settlement, paid insurance premiums and participated in the settlement negotiations so that it is "like" a party to the *RTC* action. Yet, they cannot offer a single case holding that being "like" a litigant is the equivalent of actually being a litigant for purposes of federal court jurisdiction.

The importance of requiring actually litigant status in the *RTC* action to establish jurisdiction is two-fold. First, it is the act of filing a claim against a party which gives the Court power over it. As the *Geldermann* Court noted, while parties are bound by the decisions of the district court, non-parties are not bound. Thus, non-parties have everything to gain and nothing to lose in trying to purchase petitioners' rights from the government. 975 F.2d at 698.

It is undisputed that the district court could not enter a judgment against Pinnacle and in favor of petitioners if Pinnacle were not an actual party in the *RTC* action. *Martin v. Wilks*, 490 U.S. 755, 768, 109 S.Ct. 2180, 2187, 104 L.Ed.2d 835 (1989) ("All agree that '[i]t is a principle of general application in Anglo-American jurisprudence that one is not bound by a judgment *in personam* in a litigation in which he is not designated as a party or to which he has not been made a party by service of process.'").

Second, the jurisdictional requirement of naming Pinnacle in the *RTC* action serves the important policy function of providing a check on collusive settlements. Without a complaint against Pinnacle in the *RTC* action, there is no benchmark against which to measure the reasonableness of the settlement.[3] In *Geldermann*, the Tenth Circuit cautioned against

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[3] The District Court applied Arizona law, which in turned looked to California law for determination of the good faith settlement. [Pet. at A44 citing *City of Tucson v. Superior Court*, 161 Ariz. 441, 444, 778 P.2d 1337, 1340 (Ct. App. 1989), *aff'd*, 165 Ariz. 236, 798 P.2d 374 (1990) which imported California good faith settlement determination standards.] California

allowing the government to bargain away the rights of other litigants because of the danger of collusion stating:

> The FDIC obviously could enhance the attractiveness of the settlement to the Settlors if it were able to bargain away not only its claim against the Settlors, but also the claims that other entities (including entities that are not even part of the *Sevier* or *FIS* suits) might have against the Settlors.

975 F.2d at 698.[4]

Here, the danger of collusion was particularly high. The absence of any pleadings setting forth Pinnacle's potential liability in the *RTC* action prevented the district court from making a determination of good faith. Since the RTC's theories and the size of its damages against Pinnacle remained undisclosed, the district court, as a matter of law, could not determine if the settlement was reasonable. *Arthur Young & Co. v. Helmer*, 38 Cal.App.4th 1337 at 5, *modified on denial of reh'g.*, 1995 WL 627773 (1995) ("If 'there is no substantial evidence to support a critical assumption as to the nature and extent of a settling defendant's liability, then a determination of good faith based upon such assumption is an abuse of discretion.'"). Pinnacle also concedes this point, stating "it is hard to say that the settlement would or could have been any fairer had Pinnacle been added a party to the *RTC* Action."

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law requires that all parties covered by the good faith settlement are parties to the action. *Arthur Young & Co. v. Helmer*, 38 Cal.App.4th 1337 at 3, *modified on denial of reh'g.*, 1995 WL 627773 (Cal. App. 1995).

[4] The RTC also asserts *Geldermann's* reliance on Federal Rules of Civil Procedure Rule 17 is not applicable. However, to the extent that the FDIC in *Geldermann* could not be a stocking horse for a non-party, so too, the RTC cannot be a stocking horse for Pinnacle in the *RTC* action where it is not a party. Because the district court found that Pinnacle "[was seeking a bar order for itself" [Pet. at A33], Pinnacle should have been joined as a party.

[Pinnacle's Opp. at 22] Petitioners have an absolute right to know if the settlement is fair and unless the petition for certiorari is granted, no one will ever know. Thus, the Court should grant the petition to review the district court's good faith settlement determination because it is an unwarranted extension of judicial power.

IV. THE PARTIAL SETTLEMENT IMPOSED A PENALTY WITHOUT DUE PROCESS OF LAW.

Respondents also do not dispute that "[P]arties who choose to resolve litigation through settlement may not dispose of the claims of a third party . . . without that party's agreement." *Martin*, 490 U.S. at 768, 109 S.Ct. at 2188, *quoting Firefighters v. Cleveland*, 478 U.S. 501, 529, 106 S.Ct. 3063, 3079, 92 L.Ed.2d 405 (1986); *Geldermann*, 975 F.2d 698 n.4. In fact, neither *Martin* nor *Firefighters* are even mentioned in Respondents' briefs. Thus, the settlement and bar order violated petitioners' due process rights by depriving them of claims against Pinnacle, which are not co-extensive with the proportional judgment rule, as discussed *infra* in section V.

Nevertheless, the RTC asserts that "petitioners were not singled out for adverse treatment." [RTC's Opp. at 13] However, the government ignores the fact that its own punitive conduct has necessitated this litigation over the settlement. After all parties save petitioners, agreed to the settlement, the excess insurers' offered to pay Rice and Modzelewski's compensation claims above and beyond the amount paid out in the settlement to end this litigation. However, as the district court later noted, "[t]he RTC was unwilling to accept settlement on these terms." (R. at 1705 ¶ 15.)

The insurers had good reason to offer to pay the petitioners' pension claims on top of the settlement, because of the potential exhaustion of the insurance policies. As the district

court noted, "both the RTC and [Petitioners] maintain that substantial coverage exists with respect to the RTC claims; the insurers, of course disagree." (R. at 1705 ¶ 16) The insurers' willingness to pay petitioners' settlement claims demonstrates the substantial stakes of the coverage battle petitioners are now forced to undertake.

Finally, petitioners were offered disparate settlement terms. Their pension claims far exceeded the pension claims of the settling defendants. Moreover, none of the settling defendants were offered payment of their pension claims. [Pet. at 8-9] Forcing Mr. Rice to give up his $4.2 million pension claim after winning one appeal in a separate lawsuit is clearly punitive conduct. *Modzelewski v. RTC*, 14 F.3d 1374 (9th Cir. 1994) (holding Mr. Rice's pension benefits were vested). The RTC's efforts to force petitioners to give up their pension claims and refusal to allow the insurers to pay petitioners' pension claims amount to punishment without due process.[5]

V. THE DISTRICT COURT SHOULD HAVE EVALUATED PETITIONERS' INDEMNIFICATION CLAIMS UNDER ARIZONA LAW BECAUSE THE PROPORTIONATE JUDGMENT RULE IS NOT CO-EXTENSIVE WITH ARIZONA'S COMMON LAW INDEMNIFICATION FOR PASSIVE NEGLIGENCE.

Pinnacle concedes that the Ninth Circuit failed to distinguish between contribution and indemnification legal standards under federal securities law and garden variety state

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[5] The RTC attempts to justify its intransigence with the proposition that "the government is not constitutionally required to offer settlement on any basis whatever[.]" [RTC's Opp. at 13] Yet, to date the RTC still has not explained how any legitimate governmental interest has been further by such a punitive refusal, after its settlement terms were already met.

law negligence and breach of fiduciary duty actions brought under FIRREA. [Pinnacle's Opp. at 24] Under federal securities law, indemnity and contribution are considered essentially the same. *See In re U.S. Oil & Gas Litigation*, 967 F.2d 489, 495 (11th Cir. 1992).

In contrast, the district court in applying indemnity and contribution rules in the *RTC* action based upon Arizona law must follow state law. *O'Melveny & Myers v. FDIC*, ___ U.S.____, 114 S.Ct. 2048, 2053, 129 L.Ed.2d 67 (1994). Under Arizona law, even if petitioners are found to have breached a duty owed, they may still seek indemnification because there is a distinction between passive and active tortious conduct. *Busy Bee Buffet v. Ferrell*, 82 Ariz. 192, 310 P.2d 817, 820 (1957) (a passively negligent defendant can seek indemnification from an actively negligent defendant); *DePinto v. Landoe*, 411 F.2d 297, 301-302 (9th Cir. 1969) (a director passively breaching his fiduciary duty to a corporation can seek indemnification from other directors under Arizona law).

Respondents, of course, contest petitioners' right to seek common law indemnification from Pinnacle for any recovery the RTC obtains from petitioners on the RTC's negligence, gross negligence and breach of fiduciary claims.[6] While the RTC ignores *In re San Juan Dupont Plaza Hotel Fire Litigation*, 45 F.3d 564, (1st Cir. 1995), Pinnacle simply states the case is irrelevant. [Pinnacle's Opp. at 25-26 n.30] However, the *San Juan* Court stated one of the grounds for reversing summary judgment was the district court's failure to "discuss the asserted distinctions between the duty to indemnify and a duty to defend or their connection to the claims of contribution [under state law]." Id. at 569. Thus, at least the First Circuit requires

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[6] The RTC and Pinnacle's citation to cases stating "Generally, there is no indemnity among joint tortfeasors" clearly indicates that Arizona recognizes exceptions to the general rule. [RTC's Opp. at 9 n.5.; Pinnacle's Opp. at 25 n. 29]

disputes about the state law indemnity claims to be resolved by the trial court in the first instance.

Finally, Pinnacle's statement that "the District Court discussed Arizona law in reaching its decision to approve the settlement (Pet. at A38-39, A43-44)" is accurate as far as it goes. [Pinnacle's Opp. at 24] However, Pinnacle's reference is misleading. The Court must recognize that the District Court's discussion of Arizona law was unrelated to the contribution and indemnification issues presented. Under such circumstances, the District Court should have decided this issue before it approved a settlement barring those claims.

VI. CONCLUSION

The Court just determined in *Matsushita* that it was important for the Court to decide a settlement bar issue involving the power of a state court to bar federal securities law claims over which the state court did not have jurisdiction. This petition presents the Court an equally important settlement bar issue involving the power of a federal court to bar state law claims against non-parties over which the federal court had no jurisdiction. Based upon the arguments presented, petitioners respectfully submit that, the Court should issue a writ of certiorari reviewing the Ninth Circuit's decision.

Respectfully submitted,
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